FINAL REPORT
HUD HOUSING CERTIFICATE FUND
NEGOTIATED RULEMAKING ADVISORY COMMITTEE

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Executive Summary

This Report summarizes the background, formation and deliberations of the U.S. Department of Housing and Urban Development (HUD) Housing Certificate Fund Negotiated Rulemaking Advisory Committee. It then presents the Committee's recommendations on the design of a system for allocating funding for the tenant-based Section 8 program.

The Committee was chartered by HUD in March 1999 as required by the Quality Housing and Work Responsibility Act of 1998, Section 556. The Committee's charter stated "The purpose of the Committee is to discuss and negotiate a rule that would change the current method of distributing funds to public housing agencies (PHAs) for purposes of renewing assistance contracts in the tenant-based Section 8 program. The committee will consist of persons representing stakeholder interests in the outcome of the rule."

In addition to HUD, other stakeholder groups represented on the Committee included 1) public housing agencies that administer the Section 8 program through contracts with HUD; 2) public interest groups representing the needs and concerns of Section 8 program participants and low income families; 3) independent public accounting firms that assist housing agencies in administering Section 8 finances; and 4) regional/national associations of public housing agencies. The Committee's work was facilitated by a team from the Consensus Building Institute, Inc. Technical assistance was provided by Andersen Consulting in collaboration with staff from HUD and from several Committee members' organizations.

The Committee held six meetings and numerous working group meetings and telephone conference calls between April 24, 1999 and September 29, 1999 to seek consensus on a set of recommendations to HUD, and on the text of a draft Regulation and draft Notice to implement the renewal funding system. The Committee reached consensus on recommendations addressing eight renewal funding issues:

1. Minimum number of families served
2. Resolution of Baseline Issues
3. Budget Increment Renewal and Adjustment
4. Improvement of Annual Adjustment Factors and Procedures
5. Use and Replenishment of PHA Project Reserves
6. Recycling of Reserve Funds
7. Reallocation of Budget Authority
8. Administration of the Allocation System

The Committee also reached consensus on the text of a draft Regulation and draft Notice to implement these recommendations. HUD committed to incorporate the language of the draft Regulation and draft Notice to the fullest extent possible in the final Regulation and Notice.

I. Background to the Negotiated Rulemaking

The U.S. Department of Housing and Urban Development (HUD) administers the tenant-based Section 8 rental housing assistance program. This program now assists roughly 1.4 million low-income households who need financial assistance to rent homes from private landlords. HUD distributes funds for Section 8 vouchers to 2,682 public housing agencies (PHAs) across the country.

Until recently allowable costs in the tenant-based Section 8 program were set using a Fair Market Rent (FMR) for each major housing market and rents were adjusted annually for inflation. Over the years, the actual per unit cost incurred by PHAs in many local markets did not rise as fast as the adjusted FMR. Consequently, the tetant-based Section 8 program accumulated substantial (unspent) budgetary reserves.

As a result, since the mid-1990s, Congress, the GAO, and other oversight bodies have raised concerns about the accumulation of unused budget authority for the Section 8 program. Although there were concerns with the program's administration, Congress, advocacy groups for the poor, and private rental housing owners generally supported (and continue to support) the Section 8 program as an effective, market-based strategy for providing access to affordable rental housing for the poor.

In response to these concerns, HUD has begun changing the procedure for allocating budget authority to PHAs from a formula using a fixed inflation factor over several years to one based on PHAs' actual costs from year to year. HUD has also undertaken a number of initiatives through the Section 8 program to support welfare reform (e.g. the Family Self-Sufficiency and Welfare to Work), as well as concentrating more assistance on the poorest families through income targeting. To support the new procedures and initiatives, HUD has made significant administrative and staffing changes to the Section 8 program.

The combination of changes in Section 8 allocation procedures, new initiatives, and HUD staff turnover has created significant communication and implementation challenges for HUD and other Section 8 stakeholders. These challenges have led to some frustration among PHA and HUD staff and other stakeholders regarding program mandates and procedures. HUD's leadership has acknowledged the transition challenges, while remaining confident that the changes being made now will lead to substantial long-term benefits for families served by the program and for PHAs administering it.

In October 1998, the passage of the Quality Housing and Work Responsibility Act (QHWRA) accelerated the process of change in Section 8 allocation procedures. In Section 556 of the Act, Congress mandated that HUD develop within one year a rule on renewal funding procedures for expiring tenant-based Section 8 annual contribution contracts (ACCs).

Congress indicated that the renewal formula should apply "an inflation factor based on local or regional factors to an allocation baseline." It also indicated that the baseline should "ensure continued assistance for the actual number of families assisted as of October 1, 1997, with appropriate upward adjustments for incremental assistance and additional families authorized subsequent to that date" (Quality Housing and Work Responsibility Act of 1998 (PL 105-26), Section 556(dd)). Congress also mandated that HUD use a negotiated rulemaking process to develop its new rule (Section 556 (b)).

II. Formation of the Negotiated Rulemaking Advisory Committee

In a negotiated rulemaking, the agency responsible for developing a new rule or regulation seeks to engage representatives of groups likely to be affected by the rule in drafting it.[1] These representatives, invited, convened and organized as a federal advisory committee and working directly with agency representatives, provide advice and recommendations to the agency, with the goal of reaching consensus on a draft rule. The agency, while it retains final decision-making authority, commits to be guided by the work of the committee in its decision-making, especially if a consensus is reached.

By working directly with all relevant stakeholders, the agency should be better able to develop a rule that reflects the knowledge and perspectives of all stakeholders, meets their interests and needs more creatively and efficiently than a rule developed without their input, and has the political and organizational support of both the agency and the stakeholders.

HUD identified several key stakeholder groups for participation on the Committee: public housing agencies that administer the Section 8 program through contracts with HUD; public interest groups representing the needs and concerns of Section 8 program participants and low income families, independent public accounting firms that assist housing agencies in administering Section 8 finances; and regional/national associations of public housing agencies. HUD also designated a Deputy Assistant Secretary to represent HUD on the Committee, and assigned a senior staff person as the Committee Secretary.

To improve the transfer of information between HUD and the PHA representatives, HUD established a cooperative agreement with a team of professional facilitators from the Consensus Building Institute (CBI), a non-profit mediation and facilitation service provider based in Cambridge, Massachusetts. The primary responsibility of the CBI facilitation team was to assist Committee members to explore issues, develop options

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[1] Congress authorized the use of negotiated rulemaking by Federal agencies under the Negotiated Rulemaking Act of 1996, PL 104-320, 110 Stat. 3870 (1996).

and reach agreement on recommendations to HUD on the substance of an allocation rule and related administrative issues.

HUD also contracted with Andersen Consulting to provide technical assistance to the Committee, primarily by presenting and analyzing data from HUD's Section 8 financial and administrative information systems. In addition, a number of HUD staff served as resource people throughout the process.

III. Convening Process and Report

HUD and CBI agreed that the facilitators should begin the negotiated rulemaking process by interviewing representatives of key stakeholder groups identified by HUD and other stakeholders, and then drafting a "Convening Report" based on those interviews. The goals of this convening process were to

- ensure that the Committee's membership would represent the range of organizations and groups with an interest in Section 8 renewal funding issues;
- identify key issues for discussion and negotiation;
- summarize the range of stakeholder perspectives and interests on each issue;
- make a recommendation on whether to proceed with a Negotiated Rulemaking;
- if the recommendation was positive, prepare a draft mission statement, ground rules and work plan for the Advisory Committee, taking into account the October 1999 deadline for HUD to publish a final rule.

Based on information gathered and analyzed through the interview process, the CBI team recommended that HUD charter and convene an advisory committee for the negotiated rulemaking. CBI also made recommendations to HUD on the Committee's membership to ensure full representation of stakeholder views.

The CBI team also produced a draft Convening Report. The draft Report was circulated to all of those interviewed for comment, revised and finalized based on comments received at meetings of the Committee. (Please see the Convening Report at Attachment A.)

I. Negotiated Rulemaking Process

HUD published the Committee's Charter in March 1999. The charter stated: "The purpose of the Committee is to discuss and negotiate a rule that would change the current method of distributing funds to public housing agencies (PHAs) for purposes of renewing assistance contracts in the tenant-based Section 8 program. The committee will consist of persons representing stakeholder interests in the outcome of the rule." It also included a list of organizations to be represented on the Committee. (Please see the Charter at Attachment B and the List of Committee Members at Attachment C).

Committee Meetings

The revised Convening Report became the basis for discussion at the first meeting of the Advisory Committee. The Report identified four key issues to be addressed in developing a renewal funding rule:

- setting the unit baseline;
- calculating actual costs;
- adjusting budget allocations to reflect changes in actual costs; and
- developing systems and procedures to support efficient, transparent, fair and flexible administration of the rule.

At the first meeting of the Committee, the members reviewed and discussed the Convening Report, revised the draft mission statement, ground rules and work plan, and began discussion of the baseline issue. (Please see the Mission Statement, Ground Rules and Work Plan at Attachment D).

During four subsequent meetings, the group continued discussing and exploring the key issues, seeking to develop a consensus set of recommendations on these issues for HUD consideration.[2] In addition to meetings of the full Committee, a number of Committee members and alternates, consultants and HUD staff participated in Working Group meetings, conference calls and e-mail exchanges to develop options and recommendations for consideration by the full Committee.[3]

The CBI facilitation team took responsibility for setting the agenda for each meeting in consultation with HUD and other Committee members. CBI also provided summaries of each meeting and assisted in drafting the Committee's recommendations. Andersen Consulting provided data and analysis on a number of issues.

Each of the Committee meetings was open to the public for observation, and each meeting included opportunities for public comment and feedback. At several meetings, observers from PHA associations, individual housing agencies, and OMB (the Federal Office of Management and Budget) provided useful comments and suggestions to the Committee.

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[2] Meetings of the Committee were held April 27-28 and June 2-3 at the Hyatt Dulles Hotel in Herndon, VA; June 21-22, July 19-20, and August 19-20 at the Hilton Dulles Hotel in Herndon, VA; and September 28-29 at the Crown Plaza Hotel, in Washington D.C.

[3] Working group meetings/telephone conference calls were held on May 20, June 14, July 13, July 26, July 29, September 2, September 13 and September 17. Those who attended in person met at HUD Headquarters in Washington, D.C.

The Committee reached consensus on its recommendations to HUD at its August 19-20 meeting (please see the recommendations at Section VII below).

At the August 19-20 meeting, the Committee also began reviewing and discussing a draft of the renewal funding Regulation prepared by HUD staff. The Committee continued discussion and negotiation on the draft Regulation and an accompanying draft Notice via telephone conference calls and e-mail through the third week of September. The Committee reached consensus on a draft of the regulation and accompanying notice on September 29, 1999. (Please see the consensus draft Regulation and Notice at Attachment E).

Following is a brief summary of key issues discussed and negotiated at each meeting of the full Committee. (Please see the full summaries of each meeting at Attachment F).

V. Summary of Meetings

Meeting 1: April 27-28, 1999, Hyatt Dulles Hotel, Herndon, Virginia

The first meeting of the Reg Neg Committee provided an opportunity for the committee members to meet each other, HUD staff members working on the rule, the facilitation team from CBI, and a team of consultants from Andersen Consulting which HUD had retained to assist the committee in analyzing numerical data.

The Committee reviewed and revised the draft Convening Report, mission statement, ground rules and work plan prepared by the Consensus Building Institute (see Attachment C). HUD staff then presented an overview of the current renewal funding allocation process, as established by HUD Notice PIH 98-65.

The Committee also began discussion and negotiation on the issue of setting the unit baseline. Key questions raised were 1) whether the procedure used by HUD to set the 10/1/97 baseline as established in QWHRA had accurately accounted for PHAs' contracted and leased units as of that date; 2) whether there was an alternative way to set the baseline that would be more accurate and equitable in its treatment of PHAs; and 3) whether it might be possible to develop a procedure for individual PHAs to ask HUD to review their baselines using additional documentation that the PHA would provide. Members agreed that HUD, Andersen and several PHA members would work together before the next meeting to review the baseline setting process, focusing on several PHA members as "test cases."

The Committee then began discussion of alternative ways of calculating and adjusting renewal funding. Discussion focused on the pros and cons of the current "unit-based" funding system versus a potential alternative, "dollar-based" funding system. In the current unit-based system, HUD calculates PHA annual budget authority taking the PHA's baseline number of units and multiplying each year by the inflated actual cost per unit from the PHA's most recent available year-end statement. An alternative, dollar-based system could take the PHA's baseline number of units and multiply by actual cost per unit for an initial year to generate a first-year dollar amount. In subsequent years HUD would apply an annual inflation factor to the PHA's first year dollar amount without re-calculating actual cost per unit.

The Committee also began to review the use of annual adjustment factors and other possible ways to project and budget for changes in Section 8 program costs for individual PHAs.

Meeting 2: June 2-3, 1999, Hyatt Dulles Hotel, Herndon, Virginia

Before the second committee meeting, a working group reviewed information on the baseline setting process, dollar-unit hybrid allocation systems, and alternatives to the

HUD annual adjustment factors. The working group made several recommendations to the Committee on these issues.

At the meeting, the Committee reached agreement in principle on a procedure for resolving discrepancies between PHA and HUD baseline calculations. The Committee also continued discussion on whether the PHA renewal funding formula should be unit-based, dollar-based, or some hybrid of the two.

Unit-based funding gives HUD and PHAs relatively greater certainty about future year funding amounts, but gives limited incentives for cost containment and has some disincentives for serving more than the baseline number of families within budget authority.

Dollar-based funding would allow PHAs greater flexibility to use their budgets to serve more than the baseline number of families, but would increase uncertainty about future year funding amounts. The Committee discussed possible hybrid options, including a mechanism for HUD to make periodic or case-by-case adjustments to PHA baselines and/or inflation factors in a dollar-based system. The Committee asked HUD and Andersen to develop several possible unit-dollar hybrid methods and model their impact on funding for a set of hypothetical PHAs.

The Committee also continued its review and exploration of inflation factors, and began to discuss a number of administrative options to improve efficiency, transparency and mutual accountability of HUD and PHAs in the implementation of the renewal funding system. These options included possibilities for synchronizing the award of a PHA's renewal funding increments to a single annual date, developing a procedure to recycle PHAs' unused reserve funds in excess of the two-month level to PHAs that had depleted their reserve funds to meet program goals, and allowing high-performing PHAs additional flexibility in the use of program funds to meet program goals.

<u>Meeting 3: June 21-22, 1999, Hilton Dulles Hotel, Herndon, Virginia</u>

Prior to the third meeting, a working group had continued exploring options for hybrid (unit- and dollar-based) renewal funding systems, incorporating baseline determination, annual renewal funding and adjustment factors, and had developed a draft "package" proposal for the allocation system to the full Committee.

The Committee reviewed and agreed on recommended procedure for resolving discrepancies between PHA and HUD baseline unit counts.

The Committee then reviewed the working group's hybrid system proposal and continued its discussion of how a renewal formula could work if it incorporated aspects of both a dollar-based and a unit-based system. In order to create more stability in funding from year to year, the Committee explored in detail the possibility of creating a central reserve pool of unused dollars, which might then be distributed to PHAs in need of extra dollars. HUD staff expressed concern about creating a large central reserve, since the accumulation of excess reserves was one of the catalysts for establishing a new rule. PHAs stressed that because a hybrid system raised the risk that a PHA might experience a funding shortfall, it would need to be supported by a reserve system that insured against shortfalls. It was agreed that creating a fair policy on reserves and how PHAs would be able to use their dollars was the next important issue for the group to address.

The Committee also heard a presentation from the Director of the HUD Budget Office, who explained how HUD's budget for the Section 8 program and other programs are reviewed internally, by OMB and by Congressional authorizations and appropriations committees. The presentation raised Committee members' awareness of the need for the Section 8 renewal funding allocation system to be administratively and politically compatible with the broader budget process, and to avoid creating sizable "reserve pools" that could create the appearance that budgeted funds were not being spent to meet program goals.

HUD representatives also raised the issue of how HUD should allocate program renewal funding in the event that there was a significant cut in Congressional appropriations for the program. Some Committee members felt that answering this question was beyond the scope of the Committee's work; others were interested in discussing the question further, whether through the Committee or informally.

The Committee agreed to continue working on the draft resolution of baseline issues, the draft hybrid allocation system proposal, and administrative issues.

<u>Meeting 4: July 19-20, 1999, Hilton Dulles Hotel, Herndon, Virginia</u>

Before the fourth Committee meeting, a working group continued to assess the options for unit- and dollar-based renewal funding systems. After reviewing additional data and analysis generated by HUD and Andersen, the working group found that a hybrid system based primarily on an initial year dollar allocation and subsequent application of an annual inflation factor not directly related to actual cost per unit would create unacceptable levels of budgetary uncertainty for PHAs. The primary reasons for this uncertainty are the limited available data on change in actual costs over time, and the likelihood that recent and anticipated changes in program targets and guidelines (e.g. for income targeting and deconcentration of poverty) would limit the usefulness of past data as a predictive guide to the future.

At the meeting, the committee reviewed the working group's findings and recommendations, and agreed that over the next several years HUD should continue to improve the current unit-based renewal funding allocation system, rather than switch to a dollar-based or hybrid system. The Committee recommended that over the next 2-3 years, HUD and other Section 8 stakeholders should also seek to develop and test more accurate and timely predictors of changes in PHA costs than the current HUD annual adjustment factors.

The Committee also continued to work collaboratively on the reserve issue, and refined during this meeting the idea of "Recycling" unused budget authority from one PHA to another PHA. Discussion focused on details of exactly how money might be transferred and which PHAs would be eligible for the recycled funds. Committee members identified several broad goals that the recycling of funds should strive to achieve: to serve families in a particular geographic area, to assist the families in greatest need in a particular area, and to ensure that the families with the most need for additional dollars would be eligible for them.

The Committee also discussed the possibility of permanent reallocation of units and budget authority from PHAs that were not using it to PHAs that demonstrated need and capacity to use additional authority. HUD representatives proposed several criteria and procedures that HUD might use to determine that a PHA was not making effective use of its full budget authority and therefore could face permanent reallocation of a portion of its budget authority. A number of PHA representatives agreed that in principle there could be circumstances that would justify permanent reallocation of a portion of a PHA's budget authority, but several had major concerns about the criteria and procedures to be used. The Committee agreed to continue discussion of this issue in a working group meeting.

Finally, the committee spent some time formalizing ideas on how their recommended rule might be implemented, how HUD computer and information systems could be enhanced, and on how to continue monitoring and evaluating the new renewal funding system over the next several years.

<u>Meeting 5: August 19-20, 1999, Hilton Dulles Hotel, Herndon, Virginia</u>

Prior to the fifth Committee meeting, two working group meetings/conference calls were held to continue the discussion of a procedure for reallocating budget authority, and to refine the Committee's proposed allocation system overall. Based on these discussions, CBI circulated a draft "Final Draft Allocation System Proposal" to the Committee.

At the meeting, the Committee reviewed, modified and reached consensus on a set of recommendations to HUD on the renewal funding allocation system (presented in Section VII below).

HUD staff then presented a first draft of the renewal funding Regulation for review and revision by the committee. Although much of the Regulation was in concert with the committee's recommendations, there were some differences which concerned the Committee.

In particular, HUD introduced language in the Regulation which would give HUD broad authority to control program costs by adjusting renewal allocation funding to individual PHAs and to the program as a whole. HUD representatives explained that HUD senior staff had raised questions about how the continued use of an actual cost per unit system might interact with a new policy (derived from QHWRA) that authorizes PHAs to adjust payment standards up to 110% of FMR. They were concerned that this combination would not give PHAs adequate incentives to ensure rent reasonableness, and could lead to unacceptably rapid growth in program costs.

Committee members responded that PHAs need flexibility to increase payment standards for at least two reasons:

- to promote deconcentration of low-income households into higher-rent areas, as authorized by QWHRA and HUD;
- to ensure lease-up in markets whose FMRs have been set too low. (Where the flexibility given to PHAs to increase their payment standards to 110 percent is still not adequate, PHAs may also need to seek a higher FMR or exception payment standard.)

They also noted that historically, a substantial number of PHAs, including several represented on the Committee, have set payment standards significantly lower than 100% for low-rent neighborhoods, in order to make most efficient use of program resources. Based on historical experience, there is no reason to believe that most PHAs will jump to 110% of FMR for all neighborhoods they serve simply because they have the option to do so.

PHA representatives and other stakeholders were equally concerned that the proposed language would give HUD the option to make major changes in the allocation system produced by the negotiated rulemaking process without further consultation with Section 8 stakeholders. Further, most PHA Committee members felt that the specific concern about PHA use of payment standard flexibility was misplaced; other drivers of program costs (e.g. income targeting and deconcentration of poverty) were likely to have a greater impact on the program budget over time. The Committee agreed to continue working on this issue via e-mail and working groups.

Committee members also suggested a number of amendments and revisions to other sections of the draft Regulation, which HUD agreed to incorporate.

<u>Meeting 6: September 28-29, 1999, Crown Plaza Hotel, Washington DC</u>

Prior to the Committee's sixth and final meeting, the Committee worked intensively on the issue of program cost containment through telephone conference calls and e-mail exchanges. HUD also continued its internal review and discussion on the cost containment issue, in consultation with the Office of Management and Budget. HUD also circulated the full text of a draft Notice to accompany the rule. The CBI team assisted in facilitating the process of drafting and revision for both the Regulation and the Notice.

At the final Committee meeting, the Committee reviewed revised drafts of the Regulation and Notice that incorporated a number of comments and suggestions made since the August 19-20 meeting. The cost containment issue remained the primary focus of discussion. (The Committee referred to this as the "Section (g)" issue because the specific language on cost containment was located in Section (g) of the draft Regulation.)

HUD representatives and other Committee members discussed the underlying concerns that motivated HUD to include cost containment language, and that a number of other stakeholder representatives felt were either unlikely to materialize or outside the bounds of HUD's authority. The Committee reached consensus on language for Section (g) and the Preamble language regarding Section (g). This language distinguishes HUD's authority to contain costs case-by-case from its authority to act on a systemic basis (for categories of PHAs or for the program as a whole), clarifies that HUD would use this authority in ways that are consistent with key program goals, and commits HUD to undertake informal public consultation prior to publishing a Notice implementing cost containment measures under Section (g).

With this major issue resolved, the final hours were spent making edits to other sections of the draft Regulation and its accompanying Notice, reaching final closure on issues of recycling and reallocation of budget authority and other renewal issues.

After an opportunity for final public comment, the Committee spent a few moments recognizing the spirit of serious purpose, creativity, joint problem-solving and relationship building that had animated the Committee's work. HUD representatives thanked the Committee members for their diligent participation over a long Reg Neg process, and expressed desire to work cooperatively with Committee members in the future. The CBI facilitation team complemented the Committee on its work, and noted that the Committee had reached full consensus (no dissent by any member of the Committee) on its recommendations to HUD and on drafts of the Regulation and the Notice.

VI. Committee Recommendations on the Allocation System[4]

The Committee reached consensus on the following recommendations at its August 19-20, 1999 meeting.

HUD HOUSING CERTIFICATE FUND
NEGOTIATED RULEMAKING ADVISORY COMMITTEE
RECOMMENDATIONS TO HUD
ON THE SECTION 8 RENEWAL FUNDING ALLOCATION SYSTEM

Under the Quality Housing and Work Responsibility Act enacted by Congress in 1998, PHAs should be encouraged to manage their Section 8 programs in an efficient manner, in order to serve as many families as possible within their budget allocation and no fewer than their baseline number of units. In light of these goals, the Committee, having reviewed several unit- and dollar-based renewal funding systems, proposes the following eight-part refinement of the existing HUD allocation system. The following recommendations shall not be construed to mean that HUD is obligated to provide funding beyond its congressional appropriation.

1. Minimum number of families served

Each PHA must continue to be supported at a level sufficient to serve, at a minimum, the number of families that it was serving as of 10/1/97. To achieve this goal, HUD will continue to support a "baseline" number of units for each PHA. For each PHA, this baseline number of units will be equal to the higher of contracted or leased certificates plus the higher of contracted or leased vouchers, adjusted for any increases or decreases in incremental units under ACCs issued after 10/1/97.

2. Resolution of Baseline Issues

HUD will notify each PHA of 1) the number of baseline units that HUD has allocated to it; and 2) the procedure and data that HUD used to determine its baseline unit allocation. HUD will establish a procedure for PHAs to request a review and revision of their

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[4] This document represents the consensus in principle reached during the August 19-20 meeting. It should be noted that the consensus of the Committee evolved during the process of drafting the actual text of the regulation and the notice to encompass the text of those two documents as drafted at the conclusion of the September 28-29, 1999 meeting. This recommendation document often indicates that HUD "will" adopt specified policies or take certain actions. HUD believes that the recommendations are sound but does not view the recommendation document as binding it to follow the recommendations or to preclude alternatives based on changes in circumstances. HUD is bound by the text of the published rule and will be bound by the text of the Notice when it is published. HUD intends to respect the consensus of the committee to the greatest extent possible in completing its development of the Notice.

10/1/97 baseline unit allocations. HUD will notify all PHAs of this procedure and the deadline for submitting requests.

PHAs that believe that their baseline unit allocation is inaccurate will need to submit requests and provide HUD with supporting documentation before the deadline. The designated HUD office will review PHA requests and make a decision within a fixed period of time. If HUD decides to make an adjustment to the baseline and if funding is available, the adjustment will be included in the PHA's funding for the current fiscal year. HUD may make the adjustment in the following fiscal year if an adjustment in the current fiscal year is not possible.

PHAs that disagree with HUD's decision may appeal the request to a HUD office designated to receive appeals. The decision of this office will be final.

3. Budget Increment Renewal and Adjustment

HUD will renew budget authority for PHA budget increments expiring after the promulgation of this rule by multiplying the PHA's baseline units (holding harmless the budget authority for unexpired multi-year contracts) by actual average unit cost figures from the PHA's most recent approved fiscal year-end statement total of funds required, and then by inflating that amount by the appropriate HUD annual adjustment factor (AAF) to the effective date of the renewal.

If a PHA believes that the change in its actual per unit costs for the coming fiscal year will be substantially different (higher or lower) than predicted by its AAF, the PHA may submit documentation of its current and projected actual costs and a request for a change in its budget authority to the designated HUD office. In reaching a decision, HUD will consider documentation provided by the PHA, data from HUD's MIS system, and the availability of program funds.

HUD will also have the option to review the PHA's use of funds to confirm that they are being spent in accordance with program goals. Based on this review, HUD will have the option to require the PHA to change its management practices and policies as a condition for budget approval (as it does in any case under the ACC).

If the increase in the PHA's ACPU cannot be justified in terms of good management practices, HUD will also have the option to adjust the PHA's budget to reflect per unit costs below the ACPU submitted by the PHA. HUD will also have the option to restrict the PHA's access to its reserves.

4. Improvement of Annual Adjustment Factors and Procedures

During the period 2000-2002 HUD and other Section 8 stakeholders will continue to seek ways to improve the annual adjustment process. To do so, HUD will create a stakeholder advisory group to assist in developing an adjustment factor research and pilot testing strategy.

The researchers implementing the strategy will gather data on PHAs' actual costs, including data on changes in rents, tenant incomes, bedroom size distribution and other cost factors. They will seek to develop adjustment factors and procedures that are more accurate and timely than the current AAFs. They will pilot test the use of these factors and procedures with a representative sample of PHAs.

If HUD and other stakeholders are able to develop adjustment factors and procedures that are more accurate and timely than the current AAFs, then HUD will revise the allocation system to use the more accurate factors and procedures.

5. Use and Replenishment of PHA Project Reserves

The Committee recommends that HUD continue to provide a two-month reserve for each PHA.[5] In the Committee's assessment, current and anticipated changes in Section 8 program goals and policies (e.g. income targeting, deconcentration goals, merger of voucher and certificate programs) will make it difficult for PHAs to accurately predict their program costs during the next several years. PHAs will need to have access to reserves in addition to their annual budget authority to cover unanticipated increases in program costs.

Non-troubled PHAs (SEMAP score above 60 and not in breach of their ACC) should be authorized to use up to 50% of their two-month reserves under the following circumstances:

a. if a PHA experiences increases in unit costs over and above its allocated budget authority, it may use its reserves to lease up its baseline number of units for the current fiscal year.

In this circumstance, HUD will replenish reserves up to the 2-month level, subject to the availability of funds.

b. if a PHA is able to support more than 100% of its baseline units within its budget authority ("statutory leasing"), the PHA may use its reserves in the following fiscal year to maintain families in housing while attriting to 100% of baseline. The PHA may not continue to use reserves to support units beyond the baseline number in the following fiscal year.

HUD will ensure that SEMAP scoring does not penalize PHAs who use reserves for this purpose. HUD will not replenish PHA reserves used for this purpose.

c. if a PHA wishes to maintain an average 100% lease up rate for the fiscal year, it may use its reserves to lease up to 105% of baseline within the fiscal year. PHAs using reserves for this purpose are responsible for achieving attrition back to the baseline.

In this circumstance, the PHA is responsible for replenishing its reserves from its budget authority. HUD will not replenish PHA reserves used for this purpose.

PHAs may request authorization from HUD to use more than 50% of their reserves to meet program goals. Before approving such requests, HUD Field Office staff will work with PHA staff to determine why the PHA's costs have deviated from projections and explore

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5 HUD will continue to calculate the two month reserve using the following formula: actual cost per unit month (from the most recent approved year-end statement) X annual adjustment factor X baseline number of units X 2.

possible alternatives (such as management efficiencies) to address rising costs. HUD may allow more flexibility in the use of reserves to high-performing PHAs (as defined by SEMAP scores).

Note: Even if PHAs are able, through efficient management, to serve additional households in any given year (above their approved baseline), those additional units would not become part of any PHA's baseline allocation or HUD responsibility.

6. Recycling of Reserve Funds

In order to replenish PHA reserves, HUD will establish a procedure for recycling unspent PHA budget authority in excess of a 2-month reserve to PHAs that qualify for replenishment. HUD will perform this recycling as of the end of each PHA's fiscal year, using the PHA's most recent approved year-end statement. HUD will notify PHAs of the 2-month reserve amount and seek to automate the procedure for recycling as soon as possible in order to ensure timely use of Section 8 program budget authority within HUD's fiscal year.

If HUD appropriations are insufficient to replenish fully all reserves for all PHAs, HUD will replenish reserves according to a fair, simple and transparent method which takes into account current reserve levels and PHA needs.

7. Reallocation of Budget Authority

If a PHA falls below 90% lease-up rate for a fiscal year, and the PHA has used less than 90% of its budget authority for that year, HUD will notify the PHA that it needs to increase its lease-up and budget utilization rates to at least the 90% level in order to maintain its current baseline number of units.[6] The PHA will have one year after receiving HUD notification to meet these targets. HUD will also notify local government officials and encourage them to assist the PHA in meeting these targets.

PHAs in this circumstance will have several options for achieving 90% lease up and budget utilization:

a. improve internal management systems and lease-up strategies, with the option to use HUD management assistance resources (e.g. Community Builders);
b. contract with another PHA, non-profit or for-profit housing agency to take responsibility for leasing a set number of units;
c. voluntarily transfer units to another PHA using portability procedures;
d. voluntarily return a portion of its baseline allocation and budget authority to HUD.

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[6] In calculating lease-up rates, HUD will exclude units awarded from litigation, modernization, demo-dispo or HOPE 6.

If the PHA is unable to achieve the lease up and budget utilization targets within one year of HUD notification, HUD may reduce its baseline unit count and budget authority, such that the PHA would be expected to reach 90% lease up and budget utilization in the following fiscal year.

HUD will reallocate unused units and their associated budget authority through a national pool. HUD will use the following criteria in reallocating budget authority:

- PHAs' demonstrated need for additional funds;
- PHAs' performance – addressing 1) the gap between families in need and total subsidy available and 2) increased costs to meet minimum baseline
- maintaining assistance to communities that demonstrate substantial demand for Section 8 units despite the fact that they had been served by an underleasing/underutilizing PHA from which budget authority has been reallocated.

Any PHA which has lost units and budget authority may qualify for new units and budget authority if its SEMAP scores are adequate and it demonstrates a need for new units and their associated budget authority.

8. Administration of the Allocation System

Synchronized Funding: To simplify annual budget allocations, HUD will synchronize each PHA's incremental funding. To do so, HUD will develop and implement a method for standardizing each PHA's increments to a single calendar date. It will also automate the allocation process to the greatest extent possible.

Quarterly Recycling of Excess Reserves: To facilitate timely and recycling of excess reserve authority (i.e. reserves above the two-month level), HUD will develop a quarterly system for recycling unused reserves. Under this system, HUD will recycle excess reserves from PHAs with fiscal years ending in a particular quarter, and recycle these funds to replenish depleted reserves of other qualified PHAs as quickly as possible.

Transparent Calculation of Annual Budget Authority: To improve the flow of information between HUD and PHAs, HUD will provide each PHA with a detailed annual listing of its unit increments and their associated budget authority. This information may be provided as part of HUD's annual funding notification to each PHA.

More Rapid Submission and Processing of Year-end Statements: In order to increase the accuracy of information used for budget authorization, HUD and PHAs will seek to reduce the time required for PHAs to submit year-end statements to HUD and the time for HUD to review the year-end statements.

Increased Accuracy of and Access to MTCS and HUDCAPS: HUD and PHAs will seek to improve the timeliness, accuracy and completeness of information in the MTCS and HUDCAPS databases. HUD will provide PHAs with access to their MTCS and HUDCAPS data through paper reports and/or Internet-based read-only access.

VII. Recommendations on Related Issues

During the course of the 6-month Reg Neg and drafting of the rule, committee members and HUD staff discussed topics related to annual renewal of Section 8 funds, but which were not directly related to the allocation formula. The committee recommends that additional action be taken by HUD on the following topics, through additional consultation with Section 8 stakeholders, formation of new advisory committees, and/or internal review and improvement of these issues.

A. Recycling of abandoned Family Self-Sufficiency Escrow funds back to the PHAs FSS program

B. Formation of one or more advisory groups to assist HUD in drafting Notices, testing new AAF formulas, and adjusting aspects of this rule as it becomes necessary. In particular, the rule specifies a three-year period for collecting data to further refine the AAF formula, and HUD should proactively create a process by which this can occur.

C. Producing a document or creating a process which helps PHA directors and staff to educate themselves on this new rule, its implications, and strategies a PHA can employ to avoid having any of its ABA re-allocated or its program size limited in any way.